DEPARTMENT OF STATE REVENUE

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Letter of Findings: 01-20160696; 01-20160697; 01-20160698; 01-20160700; 01-20160701; 01-20160702; 01-20160703
Individual Income Tax
For the Years 2012, 2013, and 2014

NOTICE: IC § 6-8.1-3-3.5 and IC § 4-22-7-7 require the publication of this document in the Indiana Register. This document provides the general public with information about the Department's official position concerning a specific set of facts and issues. This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register. The "Holding" section of this document is provided for the convenience of the reader and is not part of the analysis contained in this Letter of Findings.

HOLDING

The Department disagreed with Electrical Contractor that it was entitled to rely on the "uncertainty test" in evaluating whether Electrical Contractor was entitled to claim research and expense credits; under either the "uncertainty test" or the "discovery test," Electrical contractor failed to establish that it was entitled to credits for expenses attributable to its construction projects.

ISSUES

I. Adjusted Gross Income Tax - Research Expense Credits Regulations.

Authority: IC § 6-3.1; IC § 6-3-1-3.5(b); IC § 6-3.1-4-1; IC § 6-3.1-4-2(a); IC § 6-3.1-4-4; IC § 6-8.1-5-1; IC § 6-8.1-5-1(c); IC § 6-8.1-5-4(a); New Colonial Ice Co. v. Helvering, 292 US. 435, 440 (1934); United States v. McFerrin, 570 F.3d 672 (5th Cir. 2009); Stinson Estate v. United States, 214 F.3d 846 (7th Cir. 2000); United Stationers, Inc. v. U.S., 163 F.3d 440 (7th Cir. 1998); Norwest Corp. & Subsidiaries v. Comm. Of Internal Revenue, 110 T.C. 454 (1998); Conklin v. Town of Cambridge City, 58 Ind. 130 (1877); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Indiana Dep't. of State Revenue, Sales Tax Division v. RCA Corp., 310 N.E.2d 96 (Ind. Ct. App. 1974); I.R.C. § 41(d); Treas. Reg. 1.41-4(a)(3)(i) (T.D. 8930); Treas. Reg. § 1.41-4(a)(c)(ii); Treas. Reg. 1.41-4(a)(3)(ii) (T.D. 8930); Comments on Research Credit Regulations, 2001-10 I.R.B. 784; 69 F.R. 22-01; 66 F.R.. 280-01; 66 F.R. 66362-01.

Taxpayers argue that the Department erred in denying research and expense credits claimed by the company of which they were shareholders on the ground that the Department imposed a "discovery" test not found in Indiana law.

II. Adjusted Gross Income Tax - Qualified Research Expense Projects.

Authority: IC § 6-8.1-5-1(c); Stinson Estate v. United States, 214 F.3d 846, 848 (7th Cir. 2000); 69 F.R. 22-010.

Taxpayers argue that the Department erred in disallowing research expense credits attributable to specific projects engaged in by the company of which they were shareholders.

STATEMENT OF FACTS

Taxpayers are individual shareholder/owners of an Indiana electric contractor. For simplicity's sake, this Letter of Findings will hereinafter designate "Taxpayer" as the electric contracting business because "Taxpayer" is an S corporation with its business income "passed through" to the individual shareholders.

Taxpayer designs and constructs electrical systems, lighting systems, and "tele-data" systems for new and existing buildings. In designing these systems, Taxpayer considers individual customer requirements, local building codes, the availability of utility services, building site conditions, construction methods, subcontractor

availability, project schedules, and safety considerations.

The Indiana Department of Revenue ("Department") conducted an audit review of Taxpayer's business records and tax returns. The audit resulted in the denial of Taxpayer's Indiana Research Expense Credits ("RECs"). The denial of the RECs resulted in an assessment of additional income tax to the individual shareholders. Taxpayer disagreed with the audit's denial of the RECs and submitted a protest to that effect. An administrative hearing was conducted during which Taxpayer's representatives explained the basis for the protest. This Letter of Findings results.

I. Adjusted Gross Income Tax - Research Expense Credits Regulations.

DISCUSSION

Simply stated and for the years at issue, does Indiana's version of the Research Expense Credit impose the T.D. 8930 "Discovery Test" or the less restrictive T.D. 9104 "uncertainty test?"

The issue is whether the Department erred in denying Taxpayer's credits for increasing research expenses. The Department determined that Taxpayer mistakenly relied on regulations published in Treasury Decision 9104 (T.D. 9104, 69 F.R. 22-01, 2004 WL) in calculating its Indiana research expense credits. The Department states that T.D. 9104 was not promulgated and was not in effect until well over eleven months after the Indiana legislature adopted IC § 6-3.1-4-4.

The Department maintains the applicable regulations are found in Treasury Decision 8930 (T.D. 8930, 66 F.R. 280-01). The Department explains that T.D. 8930 "is the only set of regulations that were promulgated and in effect on January 1, 2001 the year in which Indiana's version of the credit was promulgated.

According to the Department, T.D. 8930 imposes a "discovery requirement." According to Taxpayer, the Internal Revenue Service ("I.R.S.") eliminated the "discovery requirement" and that Taxpayer was entitled to rely on the "elimination of uncertainty" test found in T.D. 9104.

A. Department's Audit Examination.

During the years 2012, 2013, and 2014, Taxpayer claimed approximately $5,000,000 in qualifying research expenses ("QREs") entitling it to approximately $300,000 in Indiana Research Expense Tax Credits. The audit reviewed basis for the claims to determine whether Taxpayer incurred the expenses and whether it was entitled to the resulting credits. In its review, the audit referenced the "January 1, 2001" language found at IC § 6-3.1-4-4 which provides:

> The provisions of Section 41 of the Internal Revenue Code as in effect on January 1, 2001, and the regulations promulgated in respect to those provisions and in effect on January 1, 2001, are applicable to the interpretation and administration by the department of the credit provided by this chapter, including the allocation and pass through of the credit to various taxpayers and the transitional rules for determination of the base period.

The audit report noted that IC § 6-3.1-4-4 "was amended effective January 1, 2016, deleting the reference to January 1, 2001, to recouple with the current Internal Revenue Code and regulations" but that this amendment was only effective for tax years either beginning on or after January 1, 2016. Of course, this recoupling did not take effect until well after the years under consideration here.

As a basis for arriving at its conclusions, the audit cited to I.R.C. § 41(d) which defines the term "qualified research" as research:

> 1. [w]ith respect to which expenditures may be treated as an expense under section 174[;]
> 2. [w]hich is undertaken for the purposes of discovering information which is technological in nature (also known as the Discovery Test)[;]
> 3. [t]he application of which is intended to be useful in the development of a new or improved business component of the taxpayer; and
> 4. [s]ubstantially all of the activities which constitutes elements of a process of experimentation for a qualified purpose. (Emphasis added).

The audit report explained that "[f]or a taxpayer's activities to be considered qualified research, they must meet all

four tests of I.R.C. section 41(d) including the "Discovery Test." According to the Department's audit report, "The only regulations that were promulgated as in effect on January 1, 2001, were the regulations published in [T.D. 8930]." The audit report points to what it concluded were the pertinent regulations.

Treas. Reg. 1.41-4(a)(3)(i) (T.D. 8930) states:

> For purposes of section 41(d) and this section, research is undertaken for the purpose of discovering information only if it is undertaken to obtain knowledge that exceeds, expands, or refines the common knowledge of skilled professionals in a particular field of science or engineering. (Emphasis added).

This regulation then goes on to state "research is not undertaken for the purpose of discovering information merely because an expenditure may be treated as an expense under section 174."

Treas. Reg. 1.41-4(a)(3)(ii) (T.D. 8930) defines common knowledge:

> Common knowledge of skilled professionals in a particular field of science or engineering means information that should be known to skilled professionals had they performed, before the research in question is undertaken, a reasonable investigation of the existing level of information in the particular field of science or engineering.

The audit report described Taxpayer's business as follows:

> The [T]axpayer is a contractor that designs and constructs electrical systems, lighting systems, and tele-data systems in new and existing buildings. Per statements made by the taxpayer, the [T]axpayer must consider customer requirements, the existing building (if applicable), building codes, the availability of utilities, site conditions, construction methods, subcontractor coordination, project schedule and safety. Because of these many variables, the [T]axpayer states it is uncertain as to the final building design or optimal construction methods to construct the design. However, the [T]axpayer is certain of its capability to design and install a system.

The audit concluded that Taxpayer was not engaged in "qualified research" under T.D. 8930 because Taxpayer was not engaged in activities that required it to obtain information that "exceeds, expands or refines the common knowledge of skilled engineering professionals." The audit report stated:

> As a design/build construction contractor, the [T]axpayer may have uncertainty in the final design or construction methods to be used at the outset of the construction project. However, the [T]axpayer is not discovering information that is technological in nature. The [T]axpayer is conducting a reasonable investigation of the existing level of information (customer requirements, existing buildings, building codes, existing utilities, site conditions and safety) and makes decisions on how to proceed in completing the project it was contracted to complete. In other words, given a set of facts, the [T]axpayer's personnel know what to do and how to proceed. The information being gathered is considered common knowledge of a skilled professional and is not considered qualified research.

B. Taxpayer's Response.

Taxpayer states that the audit was not entitled to rely on the "discovery" regulations provided for under T.D. 8930 because those regulations did not become effective until January 3, 2001, two days after the January 1 effective date noted in IC § 6-3.1-4-4. According to Taxpayer, the only regulations in effect at the time the Indiana legislature adopted IC § 6-3.1-4-4 "were those regulations that became final on May 16, 1989, and were issued under Technical Directive ('T.D.') 8251." Taxpayer explains:

> The regulations in T.D. 8251 were later amended by T.D. 8930 and T.D. 9104, but those amended regulations did not become final until January 3, 2001 and January 2, 2004 respectively. Therefore T.D. 8903 and T.D. 9104 were not in effect on January 1, 2001 as required by Ind. Code § 6-3.1-4-4.

Taxpayer argues that the audit's conclusions were incorrect because, in relying on the T.D. 8930 "discovery" rule, the audit expanded IC § 6-3.1-4-4 "beyond its plain meaning."

In addition, Taxpayer explains that the "Discovery Test" set out in T.D. 8930 was quickly repudiated by the IRS shortly after the test was promulgated January 3, 2001. Taxpayer explains:

> [L]ess that a month after T.D. 8930 took effect on January 3, 2001, the IRS published IRS Notice 2001-19 (2001-10 I.R.B. 784) on January 31, 2001, announcing that the IRS would reconsider T.D. 8930 . . . . [O]n December 26, 2001, the IRS published regulations (REG-112991-01, p. 7) in which it eliminated the Discovery Test.

Taxpayer cites to the December 26, 2001, (REG-112991-01, p. 7) proposed regulation.

> Treasury and the IRS have determined that the definition of qualified research set out in T.D. 8930 does not fully address Congress' concerns regarding the importance of research activities in the U.S. economy. Accordingly, Treasury and the IRS have eliminated in these proposed regulations the requirement that qualified research must be undertaken to obtain knowledge that exceeds, expands, or refines the common knowledge of skilled professionals in a particular field of science or engineering.

The IRS eventually adopted superseding regulations pursuant to T.D. 9104 on January 2, 2004. The regulation adopted stated that:

> A determination that research is undertaken for the purpose of discovering information that is technological in nature **does not** require that the taxpayer be seeking information that exceeds, expands, or refines the common knowledge of skilled professionals in a particular field of science or engineering . . . . T.D. 9104, p. 10 at Treas. Reg. § 1.41-4(a)(c)(ii) (**Taxpayer's emphasis**).

Taxpayer therefore relies on T.D. 9104, P. 10 at Treas. Reg. § 1.41-4(a)(3)(i) which provides an "uncertainty" test.

> Research is undertaken for the purpose of discovering information if it is intended to eliminate uncertainty concerning the development or improvement of a business component. Uncertainty exists if the information available to the taxpayer does not establish the capability or method for developing or improving the business component or the appropriate design of the business component. (Emphasis added).

Taxpayer points out that the IRS in T.D. 9104 specifically rejected reliance on the T.D. 8930 "Discovery Test." As explained by Taxpayer:

> [T]he IRS . . . stated in the preamble to T.D. 9104 that it would not enforce the Discovery Test of T.D. 8930 for periods prior to when T.D. 9104 became final: "[f]or taxable years ending before December 31, 2003, the IRS will not challenge return positions that are consistent with these final regulations [i.e. elimination of uncertainty test]."

C. Statement of Law and Burden of proof.

1. Burden of Proof.

Tax assessments are prima facie evidence that the Department's assessment of tax is presumed correct; the taxpayer bears the burden of proving that the assessment is incorrect. IC § 6-8.1-5-1(c); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007).

IC § 6-3.1-4-4 provides that, "'Research expense tax credit' means a credit provided under this chapter against any tax otherwise due and payable under IC 6-3." Similar to deductions, exemptions, and exclusions, tax credits - such as RECs - "are matters of legislative grace." Stinson Estate v. United States, 214 F.3d 846, 848 (7th Cir. 2000). The taxpayer who claims a tax credit is required to retain records necessary to substantiate a claimed credit. Where such a credit is claimed "the party claiming the same must show a case, by sufficient evidence, which is clearly within the exact letter of the law." Indiana Dep't. of State Revenue, Sales Tax Division v. RCA Corp., 310 N.E.2d 96, 100-01 (Ind. Ct. App. 1974) (citing Conklin v. Town of Cambridge City, 58 Ind. 130, 133 (1877)).

Citing Stinson Estate, the circuit court in United States v. McFerrin summarized that "[t]ax credits are a matter of legislative grace, are only allowed as clearly provided for by statute, and are narrowly construed." United States v. McFerrin, 570 F.3d 672, 675 (5th Cir. 2009). See also New Colonial Ice Co. v. Helvering, 292 US. 435, 440 (1934) ("Whether and to what extent deductions shall be allowed depends upon legislative grace; and only as there is clear provision therefore can any particular deduction be allowed.")

In order to obtain the benefit of the RECs at issue, both Indiana and federal law require that a taxpayer maintain and produce contemporaneous records sufficient to verify those credits. See Treas. Reg. § 1.41-4(d). Moreover,

Indiana mandates that every person subject to a listed Indiana tax keep books and records, including all source documents "so that the [D]epartment can determine the amount, if any, of the person's liability for that tax by reviewing those books and records." IC § 6-8.1-5-4(a).

2. Indiana Research Expense Credits.

For income tax purposes, Indiana follows the federal tax scheme with certain modifications. IC § 6-3-1-3.5(b). Indiana also provides tax credits outlined in IC 6-3.1 which a taxpayer may claim to reduce its taxable income. One of the tax credits is the "Indiana qualified research expense" tax credit under IC § 6-3.1-4-2(a), which states that, "A taxpayer who incurs Indiana qualified research expense in a particular taxable year is entitled to a research expense tax credit for the taxable year." IC § 6-3.1-4-1 defines the credit. In part, this statute - in effect for the taxable years in question -provides:

> "Indiana qualified research expense" means qualified research expense that is incurred for research conducted in Indiana. "Qualified research expense" means qualified research (as defined in Section 41(b) of the Internal Revenue Code as in effect on January 1, 2001).

3. Indiana 2001 Regulations.

The issue is which regulations were in effect at the time the Indiana legislature promulgated IC § 6-3.1-4-4: T.D. 8521 (eff. May 16, 1989); T.D. 8930 (eff. Jan. 3, 2001); or T.D. 9104 (eff. Jan. 2, 2004)?

The Department maintains that T.D. 8930 was in effect. If so, the regulations incorporate a "Discovery Test" in which qualified research must be "undertaken for the purposes of discovering information which is technological in nature."

Taxpayer maintains that T.D. 9104 is relevant because it has "persuasive value." If so, the regulations incorporates a less restrictive "uncertainty" test in which qualified research is "intended to eliminate uncertainty concerning the development or improvement of a business component."

Taxpayer concludes that "only T.D. 8521 was in effect on January 1, 2001, so it controls under Ind. Code § 6-3.1-4-4."

The issue in this section in whether the Department should apply the "Discovery Test" for years 2003-2015 versus the "Uncertainty Test" based on the wording found in IC § 6-3.1-4-4. The Department denied Taxpayer's protest based on its failure to document that it met each part of the four part test. However, during the protest process Taxpayer protested the Department's application of the Discovery Test as put forth in Treas. Reg. 1.41-4(a)(3)(i) (2001).

Taxpayer has challenged the validity of the IC § 6-3.1-4-4 reference to the 2001 federal regulations. This reference to the 2001 I.R.C. and regulations was added by Pub. L 192-2002 (ss), § 89 in 2002, which was the first time that IC § 6-3.1-4-4 referenced a specific date. The Department has historically applied the 2001 final regulations, published under T.D. 8930 (the "2001 Final Regulations"). The 2001 Final Regulations define qualified research and development under I.R.C. § 41 to include a discovery requirement. However, these regulations were not promulgated until January 3, 2001, not January 1, 2001 (the date referred in the statute), and no portion of the regulation was made retroactive.

T.D. 8930, published in the Federal Register on January 3, 2001, contains final regulations relating to the computation of the research expense tax credit under section 41(c) and the definition of "qualified research" under section 41(d). "These regulations reflect changes to section 41 made by the Tax Reform Act of 1986 (the 1986 Act), the Revenue Reconciliation Act of 1989, the Small Business Job Protection Act of 1996, the Taxpayer Relief Act of 1997, the Tax and Trade Relief Extension Act of 1998 (the 1998 Act) and the Tax Relief Extension Act of 1999 (the 1999 Act)." T.D. 8930, 66 F.R. 280-01, 2001 WL 34028585. The 2001 Final Regulations set forth the discovery requirement for defining qualified research under I.R.C. § 41(d). Section 1.41-4(a)(3)(i) of the 2001 Final Regulations states:

> For purposes of section 41(d) and this section, research is undertaken for the purpose of discovering information only if it is undertaken to obtain knowledge that exceeds, expands, or refines the common knowledge of skilled professionals in a particular field of science or engineering.

T.D. 8930, 66 F.R. 280-01.

T.D. 8930 notes criticism by commentators to the proposed regulations (published in 1998) that this definition imposes a "discovery requirement" that was not mandated by I.R.C. § 41(d); however, the IRS and THE Treasury Department elected to retain the Discovery Test because they "continue[d] to believe that section 41 conditions credit eligibility on an attempt to discover information that goes beyond the common knowledge of skilled professionals in the particular field of science or engineering" and that the legislative history of the Tax Reform Act of 1986 (the "1986 Act") supported such a definition. T.D. 8930, 66 F.R. 280-01. T.D. 8930 further explains that the 1986 Act narrowed the definition of the term "qualified research," and cites to legislative history explaining that "Congress was concerned that taxpayers had applied the original definition of qualified research 'too broadly,'" and under the 1986 Act research must be undertaken "to discover information that is technological in nature . . . ." Id. (quoting H.R. Conf. Rep. No. 99-841, at II071 n.3 (1986)).

T.D. 8930 additionally notes that the discovery requirement is also consistent with the legislative intent of the 1999 Act. The legislative history of the 1999 Act states "[e]mploying existing technologies in a particular field or relying on existing principles of engineering or science is qualified research, if such activities are otherwise undertaken for purposes of discovering information and satisfy the other requirements under section 41." Id. (quoting H.R. Conf. Rep. No. 106-478, at 332) (emphasis in original). T.D. 8930 states:

> By referring separately to a requirement that the research be undertaken for purposes of discovering information, this legislative history again confirmed that the phrase 'discovering information' is a separate substantive requirement and not merely a phrase used to link the term research with the types of information required as the subject of the research.

Id.

T.D. 8930 also refers to case law applying the Discovery Test subsequent to the 1986 Act and prior to promulgation of the 1998 Proposed Regulations and the 2001 Final Regulations. In United Stationers, Inc. v. U.S., 163 F.3d 440 (7th Cir. 1998), the Seventh Circuit relied upon the plain language of § 41(d)(1)(B)(i) and the legislative history of the 1986 Act in determining that the taxpayer had not engaged in "qualified research" because it did not develop research programs for the purpose of discovering information. The Court stated, "Congress clearly intended . . . that qualifying research pass a high threshold of innovation and be of broad effect." Id. at 444; see also Norwest Corp. & Subsidiaries v. Comm. Of Internal Revenue, 110 T.C. 454, 489 (1998) (relying upon "ordinary meaning of the language used in the statute . . . as well as the legislative history surrounding the promulgation of the TRA 1986[.]")

Thus, T.D. 8930 clearly indicates that the Treasury Department and the IRS considered the criticisms of the Discovery Test, yet chose to retain the requirement "[i]n light of the case law and the legislative history[.]" T.D. 8930. The 2001 Final Regulations did not spontaneously implement the Discovery Test, but instead rely upon legislative, statutory, and case law guidance evidencing that Congress intended to implement such a test with the enactment of the 1986 Act, and reiterated this position in the Tax Relief Extension Act of 1999 (the "1999 Act"). Because the interpretation of the 1986 Act and the 1999 Act by the IRS and courts, the "Discovery Test" was meant to be applied based on the statutory interpretation alone. Thus, Indiana's adoption of the "Discovery Test" is consistent with IRS and the 7th Circuit interpretation of I.R.C. §41.

In response to taxpayer concerns regarding T.D. 8930, on March 5, 2001, the Treasury Department and the IRS published Notice 2001-19 announcing that the Treasury Department and the IRS would review T.D. 8930 and reconsider comments previously submitted in connection with the finalization of T.D. 8930. Comments on Research Credit Regulations, 2001-10 I.R.B. 784, 2001 WL 84197. Notice 2001-19 also provided that, upon completion of the review, the Treasury Department and the IRS would announce changes in the regulations in the form of proposed regulations. These proposed regulations were published in the Federal Register on December 26, 2001 (the "2001 Proposed Federal Regulations"). 66 F.R. 66362-01, 2001 WL 1640763. The resulting 2001 Proposed Federal Regulations departed from the "Discovery Test" and instead implemented the "Uncertainty Test":

> Uncertainty, for purposes of this requirement, exists if the information available to the taxpayer does not establish the capability or method of developing or improving the business component, or the appropriate design of the business component.

Id.

The final regulations, which replaced the "Discovery Test" with the current "Uncertainty Test" for defining qualified

research under § 41(d), were promulgated on January 2, 2004 (the "2004 Final Regulations"). 69 F.R. 22-01, 2004 WL 18938.

The Indiana Legislature would have been aware that the IRS and the Treasury Department were reviewing the 2001 Final Regulations shortly after their promulgation, via Notice 2001-19 published on March 5, 2001, and that there were concerns about the application of the Discovery Test. However, the Indiana Legislature, in 2002, after the 2001 Proposed Regulations eliminating the "Discovery Test" had already been published in December 2001, consciously selected a date prior to these revised regulations. Had the Indiana Legislature intended to adopt the "Uncertainty Test" over the Discovery Test in the 2003 Indiana Statute, it could have either referred to a date after the promulgation of the 2001 Proposed Regulations, waited until after the final regulations were promulgated in 2004, or not referred to any date at all. The application of the discovery requirement was a reasonable interpretation of IRC § 41(d) from the date the 1986 Act was enacted until the promulgation of the 2004 Final Regulations.

FINDING

Taxpayer's protest is respectfully denied.

II. Adjusted Gross Income Tax - Qualified Research Expense Projects.

DISCUSSION

The issue is whether Taxpayer is entitled to claim RECs attributable to ten construction projects undertaken by Taxpayer.

The Department's audit reviewed the projects in consultation with Taxpayer's representatives. The auditor requested additional, detailed information on the projects. According to the audit report, "[T]he [T]axpayer declined to produce any records" on the ground that "the Department's representatives were not engineers and would not be able to ascertain if [Taxpayer's] work exceeded, expanded or refined the common knowledge of skilled professionals in a particular field of science . . . ." In addition "[T]axpayer representatives stated it would be very time consuming to gather the records . . . if the Department would not guarantee the records would be accepted . . . ." Taxpayer concluded that producing the detailed records was "not worth the [T]axpayer's time . . . ."

In an email communication, Taxpayer's representative stated that "[T]axpayer would not be providing the auditor with any additional information" and that the "[T]axpayer prefers to go to protest before it provides any additional information."

The audit report concluded as follows:

> The auditor was unable to verify the amount claimed on the returns for the research credit based on the limited and incomplete information provided. The taxpayer did not provide the documentation requested that demonstrated how the amounts of the credit were calculated by the taxpayer. The dollar amount of the credit claimed could not be substantiated by the auditor.
>
> Additionally, the auditor was unable to substantiate the taxpayer's qualification for the credit in general. The auditor was unable to verify that the activities of the taxpayer would qualify as qualified research under IC 6-3.1-4 . . . .

The projects under review by the audit consisted of activities associated with the following:

- Construction of a grain bin and the associated electric controls and lighting;
- Assembling a new machine and control system for a "tank farm;"
- "Reworking" a hospital's sprinkler system;
- Installing a lighting system in an underground parking lot;
- Installing a high-rise building's replacement lighting, fire alarm, and tele-data system;
- Installing a 1,200 amp electrical control panel;
- Installing bakery's icemaker;
- Remodeling a utilities, doors, and fire alarm in a student dormitory;
- Installing a "can melter" at an aluminum manufacturer's facility;
- Installing an outdoor lighting system for an automobile dealer.

Based on information available, the audit concluded that the expenses associated with the projects did not qualify for the credit under either the T.D. 8930 "Discovery Test" or the less restrictive T.D. 9104 "Uncertainty Test."

Based on T.D. 8930's "Discovery Test" the audit report states:

> [T]he taxpayer is not discovering information that is technological in nature. The taxpayer is conducting a reasonable investigation of the existing level of information (customer requirements, existing buildings, building codes, existing utilities, site conditions and safety) and makes decisions on how to proceed in completing the project it was contracted to complete. In other words, given a set of facts, the taxpayer's personnel know what to do and how to proceed. The information being gathered is considered common knowledge of a skilled professional and is not considered qualified research.

Considering T.D. 9104's "Uncertainty Test," the audit report states:

> [T]he [T]axpayer must be discovering information to eliminate uncertainty and that uncertainty exists only if the information available to the [T]axpayer does not establish the capability or method for developing or improving the business component or the appropriate design of the business component. As previously stated, the [T]axpayer has been in business for many years and has several long time employees with education/experience in the building design and construction business. The customer is relying on and paying for this education and experience when they hire the [T]axpayer. Neither the customer nor the [T]axpayer would enter into these contracts to do the jobs if the [T]axpayer was not capable of completing the jobs or the different construction methods to complete the jobs. Even though the [T]axpayer may not know every detail of the final design when it first signs the contracts with the customer, both the customer and the [T]axpayer know that the [T]axpayer has the education/experience to prepare the appropriate design based on the customer's requirements and site conditions when they entered into the contracts.

In its protest letter, Taxpayer states the "Department does not employ individuals with a sufficient technical background to evaluate the complex documentation typically included in qualifying research and development projects." Instead, Taxpayer believes that the Department should defer to an IRS review of Taxpayer's activities which - apparently - concluded that the Taxpayer's construction and installation projects met the definition of qualified research.

As noted in Part I above, RECs are "are matters of legislative grace." Stinson Estate v. United States, 214 F.3d 846, 848 (7th Cir. 2000). When RECs are claimed, "the party claiming the same must show a case, by sufficient evidence, which is clearly within the exact letter of the law." Indiana Dep't. of State Revenue, Sales Tax Division v. RCA Corp., 310 N.E.2d 96, 100-01 (Ind. Ct. App. 1974). In this case, Taxpayer has not met its statutory burden under IC § 6-8.1-5-1(c) of establishing that costs related to its construction projects qualified as qualified research expenses, of establishing the correct amount of qualified expenses for each project, and that the proposed assessments were wrong.

FINDING

Taxpayer's protest is respectfully denied.

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